strategy+business

ONLINE JUNE 10, 2013

THE CAPABLE STRATEGIST

You Can’t Build a Winning Strategy If You Don’t Know Who You Are

The road to sustained success begins with the answer to this simple question: “Who are we?”

BY KEN FAVARO WITH PAUL LEINWAND AND NADIA KUBIS

This article was originally published by Booz & Company.

You Can't Build a Winning Strategy If You Don't Know Who You Are

The road to sustained success begins with the answer to this simple question: "Who are we?"

by Ken Favaro with Paul Leinwand and Nadia Kubis

Every enterprise is regularly confronted with questions of where to grow, how to acquire, and what should make up its business portfolio. The corporate landscape is littered with companies that have lost their way because their answers to those questions became detached from who they are: their way of creating value for customers and shareholders (or "way to play"), and the differentiating capabilities they leverage to play their way better than anyone else. These two essential components of every company's identity must work together and reinforce each other for a company to have a right to win in its particular markets (as explained in depth in Paul Leinwand and Cesare Mainardi's 2010 *Harvard Business Review* article, "The Coherence Premium").

Where Should You Grow?

Companies that sustain profitable organic growth are the ones that can consistently spot and close gaps in the market between existing offers and customer needs. For example, McDonald's saw a gap in the market for cheap and easy breakfast meals. It repurposed its unparalleled food sourcing, menu development, and kitchen management capabilities to close that gap, producing for itself an enormous new revenue stream.

McDonald's has, thus, found growth opportunities even without adding restaurants (though it has been doing this, too). No competitor has the capabilities that McDonald's has to deliver easily accessed, low-priced meals with consistent quality and service to the masses around the world. McDonald's knows where to grow because it knows who it is. It understands where it can—and cannot—extend and take advantage of its distinctive capabilities and way to play. Alas, too few organizations have this kind of self-awareness.

The CEO of a leading consumer company once said to me, "We could fill this conference room with customer research and yet we can't seem to convert it into growth." The problem? The research said nothing about gaps in the market where the company had a comparative advantage to close that gap with its particular set of enterprise capabilities. For example, the research showed that the company was not satisfying women's need for variety and size ranges in apparel. This suggested a big opportunity. But seizing it would require the company to have an adaptable supply chain, which would adversely affect its efficiency and effectiveness across the entire business. Though the company's variety and sizing pilots worked, it could not replicate them across the enterprise. By not looking at where it should grow through the lens of its own capabilities, the company was wasting a lot of time, energy, and money chasing unobtainable opportunities—and this seriously diluted its total "return on effort" to generate profitable

Ken Favaro
ken.favaro@booz.com
is a senior partner with Booz & Company and global head of the firm's enterprise strategy practice. He is based in New York.

Paul Leinwand
paul.leinwand@booz.com
is a partner with Booz & Company based in Chicago, and coauthor (with Cesare Mainardi) of *The Essential Advantage: How to Win with a Capabilities-Driven Strategy* (Harvard Business Review Press, 2011).

Nadia Kubis
nadia.kubis@booz.com
is a principal with Booz & Company based in Zurich.

organic growth.

Knowing your markets means you can identify gaps between existing offers and customer needs. Knowing yourself means understanding where your way to play and differentiating capabilities give you a substantial advantage in closing some or all of those gaps and, importantly, where they do not. If you don't have an adaptive supply chain, for example, pursuing opportunities that demand it will only set you back unless you make a concerted effort to build this capability. Knowing yourself and knowing where to grow are inextricably linked.

How Do You Acquire?

Most acquisitions result in companies getting bigger, not better. We studied nearly 800 acquisitions over 15 years with a cumulative cost of almost US$300 billion. The average pre- and post-valuation of the acquiring companies barely budged, suggesting the average deal had little effect on the growth and profitability prospects of its perpetrator. But another study revealed enormous disparity across the spectrum of acquisition results: The deals with the strongest returns displayed a clear fit between the acquirer's capabilities and those of the acquired business. Those with poor capabilities fit were in the red (see "The Capabilities Premium in M&A," by Gerald Adolph, Cesare Mainardi, and J. Neely, *s+b,* Spring 2012).

This is a rather obvious result: If you don't acquire companies that can benefit from what you do best, or if your acquisitions don't bring capabilities that help you close market gaps, you can't cover the cost of buying them. But if that's so obvious, why do we continue to see acquisitions underperforming?

The best acquisitions add value in two directions: from the acquired business to the acquiring company, and vice versa. For example, Procter & Gamble (P&G) acquired Gillette because of its expertise in innovating, making, and marketing consumer products for men; however, P&G also wanted to bring its own such capabilities for women to Gillette. Too few acquisitions have the potential to add value in two directions, and this is why so many of them fall short.

Just as with growing organically, you have to know yourself to know how to acquire. Companies spend millions conducting due diligence on the financials, liabilities, products, costs, and operations of their acquisition targets. They should be just as diligent in building an understanding of how their targets' way to play and capabilities strengthen or align with their own. Only then can they know how to make acquisitions that add value in both directions.

What Should Comprise Your Business Portfolio?

When contemplating the shape and boundaries of your company, common sense says to look at the merits of each individual business in your portfolio and on your shopping list. And standard practice says to set bars for growth, profitability, and market leadership when deciding what's in and what's out. Yet, even among companies that follow this accepted wisdom religiously, disastrous portfolio transformations continue to happen with unfortunate regularity. Vivendi, Seagram's, and Hewlett-Packard are a few of the examples from just the last decade or so.

Though it's obviously easier said than done, the solution is remarkably simple: *Regardless of how strong or weak the individual fundamentals of each business in a* *portfolio may be,* the healthiest portfolios are filled with only those businesses that gain the most from a company's enterprise capabilities (see the *s+b* Capable Strategist column "We're from Corporate and We're Here to Help"). Consider the Danaher Corporation: It has a wide range of businesses, yet they all benefit greatly from the company's same distinctive set of enterprise capabilities, such as its goal deployment and lean Six Sigma skills. The better the fit between your business portfolio and your differentiating capabilities, the more likely it is that your company will amount to more than just the sum of its individual parts. After all, in what other way do enterprises create value for the businesses they own?

Thus, the answer to "What should constitute your business portfolio?" begins with an objective understanding of—you guessed it—who you are in terms of how your company creates value and what it does better than anyone else. You should invest heavily in growing a portfolio with high coherence, where each business benefits from, and ideally contributes to, your particular capabilities and way to play. If every business also has strong individual fundamentals, your company will consistently hit the ball out of the park.

On the other hand, you should divest or discontinue businesses with poor fundamentals and those that gain little from what your company does well. You may not get a lot for them, but you will get more than what they are worth to you if they are a better fit with what another company does well. IBM was right to sell its PC business to Lenovo in 2005 because its capabilities and way to play had begun moving away from manufacturing and commodity sourcing and selling.

The toughest calls are for the businesses that fall in between. But leaders of high-performing, coherent companies have the discipline to divest or avoid businesses that have strong fundamentals yet fit poorly with what they do well. For example, GE correctly divested NBCUniversal even though it is a strong, profitable business. It simply didn't add much to GE's expertise at building, marketing, and financing engineered products. Likewise, you should fix rather than divest poorly performing businesses that ought to benefit from what you do well, even if their fundamentals are weak. Those poor fundamentals won't be a secret to potential buyers, so you are better served by learning how to add value to their performance.

Charting Your Way

Over the years we've seen scores of growth, M&A, and portfolio "strategies" touting wonderful opportunities that never came to fruition. This is because they depended on an implicit assumption that a company's fundamental identity—its way to play and differentiating capabilities—is more fungible and elastic than it really is.

In fact, the questions of where to grow, how to acquire, and what should be in the portfolio are mere tactics in the context of more existential questions: Who are we? What are we better at than any other company? How do we create value for our customers and shareholders? If you don't start here, your growth, M&A, and portfolio decisions will add up to nothing more than a random walk through the countryside. Sooner or later you'll lose your identity, and then your way. In other words, you can't build a winning strategy if you don't know who you are. +

strategy+business magazine
is published by PwC Strategy& Inc.
To subscribe, visit strategy-business.com
or call 1-855-869-4862.

For more information about Strategy&,
visit www.strategyand.pwc.com

• strategy-business.com
• facebook.com/strategybusiness
• http://twitter.com/stratandbiz

101 Park Ave., 18th Floor, New York, NY 10178

pwc | strategy&
Formerly Booz & Company